IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 31/12/2002

CORAM

THE HONOURABLE MR.JUSTICE N.V.BALASUBRAMANIAN
AND
THE HONOURABLE MR.JUSTICE K.RAVIRAJA PANDIAN

TAX CASE NO.254 OF 1999
AND TAX CASE NOS. 255 TO 259 OF 1998 AND 413 OF 1999

The Tamil Nadu Brick & Tile
Manufacturers Industrial
Service Co.operative Society
Limited, Chennai. ..... Applicant in all T.C.s.

-Vs-

The Commissioner of
Income-tax,Tamil Nadu III,
Chennai. ..... Respondent in T.C.Nos.
254 to 259 of 1998 &
413 of 1999.

!For Applicant : Mr.T.N.Seetharaman

For Respondent: Mrs.Pushya Sitharaman,
Sr.Standing Counsel for
Income-tax.

Prayer: Tax Case Nos.254 to 259 of 1998 submitted by the Income-tax Appellate Tribunal, Madras B Bench in R.A.Nos.638 to 643/MDS/1997 in I.T.A.Nos.2969 to 2974 /Mds/1990 for the assessment years and Tax Case No.413 of 1999 submitted by the Income-tax Appellate Tribunal, Madras A Bench in R.A.No.741/MDS/1996 in I.T.A.No.2924/Mds/1986 for the assessment year 1985-86.

:JUDGMENT

N.V.BALASUBRAMANIAN,J.
In all these tax cases, the common question of law referred for the opinion of this Court is as follows:
"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the 'purchase bonus' is not allowable deduction out of profits and gains of business to the society?
2. In respect of T.C.No.413 of 1999, an additional question of law is also referred to, which is as follows:
"Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the assessee society was

not entitled to deduction of Rs.40,000/- under Section 80P(2)(c)(i) of the Income-tax Act.

3. In respect of T.C.No.254 to 259 of 1998, the relevant assessment years are 1980-81, 1981-82, 1982-83, 1983-84, 1984-85 and 1987-88 respectively. The relevant assessment year in respect of T.C.No.413 of 1999 is 1985-86. Though in T.C.No.413 of 1999, the respondent is shown as the Inspecting Assistant Commissioner of Income-tax (Asst.), Range IV, Madras, only the Commissioner of Income-tax, Tamil Nadu III, Chennai should be the party/respondent. Accordingly, the cause title in T.C.No.413 of 1999 is amended showing the Commissioner of Income-tax, Tamil Nadu III, Chennai as the respondent instead of the Inspecting Assistant Commissioner of Income-tax (Asst.) Range IV, Madras.

4. The facts are identical in respect of all the assessment years.

The assessee being a Co-operative society supplied coal and diesel to its members, who are manufacturers of bricks and tiles. In respect of relevant assessment years, the assessee claimed deduction in various amounts as "purchase bonus" payable to its members. It was contended before the Assessing Authority that as per the provisions of the Tamil Nadu Cooperative Societies Act, 1961 (Tamil Nadu Act No.53 of 1961) and Tamil Nadu Co.operative Societies Act, as amended by Act 30 of 1983, the purchase bonus is payable to its members with reference to the business done by them and the sum so payable is allowable as business expenditure of the Society. However, the Assessing Officer disallowed the claim on the ground that the payment was only by way of application or appropriation of net profit already earned and cannot be deducted as expenditure incurred for earning the business income. On appeal, the Commissioner of Income-tax (Appeals) has held that though "purchase bonus" payable to each member was calculated on the basis of the extent of their business with the assessee society, it was nevertheless appropriation out of the net profit. Before the Commissioner of Income-tax (Appeals), the assessee also urged that in view of the Circular No.117, dated 22.8.1973 issued by the Central Board of Direct Taxes, the purchase "bonus payable" by the Society should be allowed as a deduction in computing the business income of the assessee society. This ground was also rejected by the Commissioner of Income-tax (Appeals) on the ground that the clarification in regard to the "rebate" or "purchase bonus" allowed to the members of the consumer cooperative societies has no relevance in the context of bonus allowable to members of the Society under the Cooperative Societies Act, in the sense, the said circular of the CBDT was applicable only to the consumer Cooperative Societies and not to the petitioner Society, which was not a consumer cooperative Society. On further appeal to the Tribunal, the Tribunal upheld the order of the Commissioner of Income-tax (Appeals), which confirmed the order of the assessing Officer. At the instance of the assessee, the reference is made as stated above.

5. Mr.Seetharaman, learned counsel appearing for the assessee has submitted that inasmuch as Section 72 of the Cooperative Societies Act, which specifically referred to the payment of "bonus" to members with reference to the business done with or service rendered to the registered society, such payment is payable not because they are members, but because they have made certain purchase from the society on the basis of which the bonus is quantified. He further contended that as per the Cooperative Societies Act, in order to ensure that the Cooperative Society does not incur loss, the bonus

to its members are paid only after closing the account and after ascertaining the net result of the profit or loss of the trading transaction. In substance, he contended that the purchase bonus paid to the members with reference to the business done is to be considered as a deferred discount. In order to sustain his contention that the "purchase bonus" payable to the members is allowable deduction, he relied on the decision of the Andhra Pradesh High Court in the case of COMMISSIONER OF INCOME TAX VS. T.T.D.CO-OPERATIVE STORES LIMITED reported in (1998) 232 ITR 109 and the decision of the Supreme Court in the case of POONA ELECTRIC SUPPLY COMPANY LIMITED VS. COMMISSIONER OF INCOME TAX, BOMBAY CITY I reported in (1965) 57 ITR 521. The learned counsel has also relied on the circular No.117 of the CBDT and contended that the Board in consultation with the Department of Community Development and Cooperation has decided that the "rebate" or "bonus", which is in the nature of deferred discount passed on by the consumer co-operative Stores to their members on the value of the purchases made by them during a year should be allowed as a deduction in computing the business income of such society and in the light of the circular issued, the purchase " bonus payable" to the members with regard to their purchase they had with the society should be allowed as a deduction in computing the business income. He has further contended that in respect of the assessment year 1990-91, in respect of the very same assessee, the Appellate Tribunal had accepted the contention of the assessee by holding that the nature of the "rebate" considered by the Andhra Pradesh High Court in (1998) 232 ITR 109 and the nature of the "purchase bonus" to the members of the assessee society was similar, that the Tribunal rejected the contention of the revenue to the effect that in respect of the assessee's own case for the assessment year 1985-86, "the purchase bonus" claimed as allowable under business income was rejected and following the decision of the Andhra Pradesh High Court in 232 ITR 109 allowed the claim of assessee in regard to "purchase bonus". No much argument has been advanced by the learned counsel for the assessee in respect of the claim under Section 80P(2)(c)(i).

6. Mrs.Pushya Seetharaman, the learned Senior Central Government Standing Counsel appearing for the respondent has pointed out that the provision specifically referred to payment of bonus out of the net profit and submitted that this was only an appropriation of income and could not be allowed as a deduction. She further submitted that where the amount is paid after arriving at the income, it must be taken as an appropriation of income, unless or otherwise there are some materials to indicate that there was a diversion of that profit by overriding title before the profit accrues. In support of her contention, she relied on a decision of this Court in the case of COMMISSIONER OF INCOME-TAX, TAMIL NADU - V VS. SOUTH ARCOT DISTRICT CO-OPERATIVE SUPPLY & MARKETING SOCIETY LIMITED reported in (1981) 127 ITR 467.

7. We heard the arguments of the learned counsel on either side and perused the materials on record.

8. In order to appreciate the rival contentions, we are of the view that it is appropriate to refer to the provisions of the Cooperative Societies Act. Section 72 of the Cooperative Societies Act, which came into force from 13.4.1988, which is corresponding to Section 62 of the 1961 Act is as follows:

"72. Disposal of net profits. - (1) (a) A registered society shall,

out of its net profits as declared by the Registrar for the purposes of this Act in respect of any year, contribute -
(i) three per cent of the net profits to the research and development fund; and
(ii) two per cent of the net profits to the education fund,
within such time and in such manner as may be prescribed.
(b) The research and development fund and the education fund shall be maintained by the Tamil Nadu Co-operative Union Limited and administered by committees constituted in accordance with the rules. Such committees shall consist of nominees of the Government (who shall be specialists or technical experts in agriculture or animal husbandry or sugar technology or textile technology or in such other matters as may be prescribed or officers of the Government) and also of nominees of the prescribed apex societies.
(2) The balance of the net profits as so declared shall be appropriated, -
firstly, for being credited to a reserve fund, the amount to credited being not less than twenty per cent of the net profits;
secondly, towards contribution to an agricultural credit stabilization fund at fifteen per cent of the net profits in the case of every agricultural service society including the State and primary agriculture and rural development banks and other financing banks:
Provided that the State Agriculture and rural development bank shall also contribute to a failed wells fund and to a project service account at such rates as may be specified in the rules;
Thirdly, towards payment of honorarium to the members of the board including the president and the vice-president of the registered society at such rates and subject to such conditions as may be prescribed :
Provided that the aggregate of the honorarium so paid shall not exceed ten per cent of the net profits;
Fourthly, towards payment of dividend on shares to members at a rate not exceeding fourteen per cent per annum on the paid-up value of each share :
Provided that the Government may by general or specific order permit any registered society or any class or category of registered societies to declare dividend at a rate exceeding fourteen per cent per annum subject to the condition that the amount of dividend in excess of fourteen per cent shall be credited to the share account of the members in such manner as may be prescribed;
Fifthly, towards payment of bonus to members with reference to business done with or services rendered to the registered society, at such rate and subject to such conditions as may be specified in the rules;
Sixthly, towards payment of bonus to paid employees of the registered society not governed by the Payment of Bonus Act, 1965 (Central Act 21 of 1965) at such rate and subject to such conditions as may be specified in the rules.
Seventhly, towards contribution to such other funds and at such rates as may be specified in the by-laws;
Eighthly, towards contribution to the common good fund at such rate not exceeding ten per cent of the net profits as may be specified in the rules; and
Ninthly, the remainder, if any, of the net profits being credited to the reserve fund."

9. As seen from the above provision, it is evident that the provision provided for disposal of net profits and clause (i)(a) of Section 72 provides that a registered society shall "out of its net profits", as declared by the Registrar for the purposes of this Act in respect of any year contribute three per cent of the net profits to the research and development fund and two per cent of the net profits to the education fund. Sub-section (2) provides that the balance of the net profits as so declared shall be appropriated, -
firstly, ?..
secondly,
thirdly, ?
fourthly, ?.
Fifthly, towards payment of bonus to members with reference to business done with or services rendered to the registered society, at such rate and subject to such conditions as may be specified in the rules.

10. The corresponding Rule viz., Rule 96 of the Tamil Nadu Societies Rules, 1988 provides that any society other than a credit society may, in accordance with its by-laws, pay bonus to its members based on the extent of business done by the members with it or the value of the services rendered by such members to the society subject to a maximum of fifty per cent of its net profits. The Rule also provides that the Society shall not utilize any portion of the bonus accruing on the business done by non-members for payment of bonus to members but shall carry the entire amount so accrued to the reserve fund or business loss reserve as may be decided by the general body.
11. A careful reading of section 72 of the Co-operative Societies Act and Rule 96 of the Tamil Nadu Co-operative Societies Rules shows that the disbursement out of net profit as declared by the Registrar of Co-operative Societies is not lo robably, the arrangement of various sub-sections as to the disbursement of net profit of a Co-operative Society has been made keeping in mind the object of the Co-operative Societies Act that the net profit of the Co-operative Society is not to be dissipated. In other words, the arrangement under the Co-operative Societies Act has no relevance for the determination of taxable profits under the Income-tax Act. Under Section 72 of the Co-operative Societies Act, the payment of dividend is found in 4 th sub-heading and bonus to paid employees is found in 6th subheading. However, under the Income-tax Act, the bonus to employees would figure as a proper deductible item in the computation of net profits and only after the declaration of net profit, the dividend has to be declared depending upon the net profits of the Co-operative Society. Hence, it is ex-facie clear that the arrangement of disbursement out of net profits under the Co-operative Societies Act is not logical and it has no relevance to the determination of taxable profits under the Income-tax Act. Though bonus to employees is characterised as a payment out of net profits, it would still be a deductible expenditure under the Income-tax Act in the computation of net profits of the Co-operative Society in the normal circumstances. Therefore, the placement regarding payment of bonus to members next to the placement of declaration of dividend on shares, in our view, is not conclusive in determining the question whether the payment of bonus to members is deductible expenditure or not. So also, the fact that under the Cooperative Societies Act, the payment of bonus to members is required to be made out of net profits of the Co-operative

Society is not conclusive in determining the question whether the said amount is a deductible expenditure in the computation of business income of the Cooperative Society under the Income-tax Act.

12. As far as the decision of this Court in C.I.T. v. SOUTH ARCOT DISTRICT CO-OP. SOCIETY (127 ITR 467) is concerned, the decision has no application to the facts of the case as this Court was dealing with the case of statutory contribution out of net profits of a cooperative society to an education fund. In such circumstances, this Court found no difficulty in holding that the amount paid to an education fund was not liable to be excluded from the taxable profits as the contribution has no connection to the earning profit. This Court also held that there was no diversion by overriding title by the creation of the education fund. This Court further found that the payment was conditional on profits being earned and that was the reason for this Court to hold that the amount paid to the education fund was not liable to be excluded from the taxable profits of the Co-operative Society. It is also relevant to mention here that in the South Arcot District Co-op. Society's case (127 ITR 467) the argument that was advanced was on the question whether there was any diversion by overriding title. Further, the following observation of this Court made in South Arcot District Co-op. Society's case is relevant for the purpose of this case:-

" The payment is conditional on profits being earned. Though that part of the profits which may have to be paid for earning the income can be allowed as deduction, this is not such a case. The nature of the liability is such that the amoun distribution out of the profits, and is not related to the earning of profits."

13. In our view, the test laid down by this Court in South Arcot District Co-operative Society's case really helps the assessee herein. The bonus to the members is paid, though after the determination of net profits of the Co-operative Society, as a sort of encouragement to the members of the Co-operative Society to purchase the goods from the Co-operative Society, and by such purchase, the income of the Co-operative Society correspondingly would correspondingly increase and the profits of the Co-operative Society would also be generated. It is given more as an incentive to the members to purchase goods from the Co-operative Society and ultimately the Co-operative Society will be benefited by the sale of articles, that too, by the sale of more articles to the members. Though the amount is given after the determination of net profits of the Co-operative Society, it is really a discount to the purchase price given to the members of the Cooperative Society for the purchases made by them. We are of the view that the fact that it is paid after the determination of the net profits under the Co-operative Societies Act is not relevant and what has to be seen is the real nature of the purchase bonus. We are of the view that the real nature and quality of the purchase bonus is really a deferred discount, that is paid to the members after determination of the net profits of the Co-operative Society. Therefore this expenditure, in our opinion, was paid for the business of the assessee and is a business expenditure and is allowable as a business deduction.

14. In C.I.T. v. T.T.D. CO-OPERATIVE STORES LTD. (232 ITR 109) wherein the Andhra Pradesh High Court considered a similar question and held that where rebate is given at the end of the year, deduction would go to the trading account and thereby the figure of sales would be reduced by the

amount of rebate given. Though the Court held that it was not a case where the deduction of business expenditure was made after ascertaining the gross profit, if the rebate was given at the end of the year after ascertaining the profit made during the year, the actual rebate would relate back to the da te of sale and the sale figure would be reduced in the trading account. We are of the view that the ratio of the decision of the Andhra Pradesh High Court would squarely apply to the facts of the case as the purchase bonus is granted to the members of the Co-operative Society as an incentive for the purpose of purchase of the goods from the Co-operative Society and if the rebate is not given, the loser would be the Co-operative Society. Therefore the payment of purchase bonus to its members, we hold, is an expenditure incurred wholly and exclusively for the purpose of business of the Co-operative Society.
15. The Supreme Court in POONA ELECTRIC SUPPLY CO. LTD. v. COMMR. OF INC.-TAX (56 ITR 521) laid down the law as under:-
" Under section 10(1) of the Income-tax Act, tax shall be payable by an assessee under the head "profits and gains of business" in respect of profits and gains of any business carried on by him. The said profits and gains are not profits regulated by any statute, but profits in a business computed on business principles. They are business profits and not statutory profits. They are real profits and not notional profits. The real profit of a businessman under section 10(1) of the Income-tax Act cannot obviously include the amounts returned by him by way of rebate to the consumers under statutory compulsion. It is as if he received only from the consu mers the original amount minus the amount he returned to them. In substance there cannot be any difference between a businessman collecting from his constituents a sum of Rs.Y in addition to Rs.X by mistake and returning Rs.Y to them and another businessman collecting Rs.X alone. The amount returned is not a part of the profits at all."

The decision of the Supreme Court makes it clear that there is a distinction between the deduction made for ascertaining profits and the distribution out of net profits. The Supreme Court also held that though there may be some difficulties in ascertaining in each case whether a particular payment falls within one or other kinds of categories, the Supreme Court noticed the decision of the Privy Council in INDIAN RADIO AND CABLE COMMUNICATIONS CO. LTD. v. COMMISSIONER OF INCOME-TAX (5 ITR 270, 277) where Lord Maugham pointed out the distinction as under:-
"It may be admitted that as Mr.Latter contended, it is not universally true to say that a payment the making of which is conditional on profits being earned cannot properly be described as an expenditure incurred for the purpose of earning such profits. The typical exception is that of a payment to a director or a manager of a commission on the profits of a company".

The Supreme Court also made the distinction between the real profit and statutory profit, that is, between the statutory profit and commercial profit to be determined by applying the commercial principles under the Income-tax law. Under the Co-operative Societies Act the statutory profit is fixed for a specified purpose and that cannot be imported for determination of commercial profit by applying the commercial principles under the Income-tax Act. Further, it is a statutory payment and when the statute has directed that the amount is liable to be paid by way of purchase bonus, the expenditure would be

allowable even on the ground that the payments were required to be made under the provisions of the statute. Though under the Co-operative Societies Act the profit bonus is to be made after the determination of net profit, when actually the payment was made for the purpose of business, it would constitute an allowable deduction under the Income-tax Act.

16. Learned counsel for the assessee also relied upon the decision of the Andhra Pradesh High Court in ARMOOR CO-OPERATIVE MARKETING SOCIETY v. C.I.T. (167 ITR 565), but the decision has no application to the facts of the case. It is also relevant to mention here that we have granted sufficient time to the Commissioner of Income-tax, Tamil Nadu III, Chennai to inform the Court as to the reasons why the Commissioner accepted the order of the Appellate Tribunal rendered in the assessee's own case for the assessment year 1990-91 and in spite of opportunities granted to the Commissioner, the Commissioner of Income-tax, Tamil Nadu III, Chennai has not furnished any information regarding the reasons for accepting the order for the subsequent assessment year. The Supreme Court in UNION OF INDIA v. SATISH PANALAL SHAH (249 ITR 221) has held that where the decision of the High Court in the case of assessee against the department is accepted in the subsequent decision of the High Court in the cases of other assessees, the department is not entitled to challenge the correctness without just cause in the cases of other assessees. The ratio laid down by the Supreme Court is apposite here as the Commissioner of Income-tax, Tamil Nadu III, Chennai has accepted the decision of the Appellate Tribunal in the assessee's own case for a subsequent assessment year, but has not given any reason at all for not accepting the order of the Appellate Tribunal for the earlier years, though it was decided in favour of the Commissioner in the earlier years.

17. The Central Board of Direct Taxes in consultation with the Department of Community Development and Co-operation has issued the Circular to the effect that rebate or bonus would be in the nature of deferred discount passed on the consumer co-operative stores to their members and there is an allowable deduction in the computation of income of the Co-operative Society though the Circular was issued in the case of Consumer Co-operative Stores, there are no reasons to take a different view that it would not be a deferred discount in the case of other co-operative societies where bonus is paid to the members of the co-operative societies on the value of purchase made by them during the year.

18. For the fore-going reasons, we are of the opinion that the conclusion of the Appellate Tribunal is incorrect. Hence the first question has to be answered in the negative in favour of the assessee and against the Revenue and accordingly it is answered.

19. With regard to the second question referred to in T.C.No.413 of 1 999, the assessee claimed deduction in a sum of Rs.40,000/- under Section 80P(2)(c)(i) of the Act. The lower authorities granted deduction of only a sum of Rs.20,000/- under Section 80P(2)(c)(ii). On appeal, the Tribunal held that the assessee is not a consumer co-operative society and it is not engaged in the business of supplying essential commodities to the common and thus upheld the deduction of Rs.20,000/- only. No such argument was made in respect of the above question. In order to answer the question, we will have to refer the provision, Section 80(P)(2)(c) provides that in the case of a co-operative society engaged in activities other than those specified in clause (a) or clause (b) (either independently of, or in addition to, all or

any of the activities so specified), so much of its profits and gains attributable to such activities as does not exceed (i) where such cooperative society is a consumers' co-operative society, forty thousand rupees; and (ii) in any other case, twenty thousand rupees only shall be deducted. The "consumer society" as defined under Section 2(10) of the Co-operative Societies Act to mean a registered society which has its principal object the supply of the requirements of its members for the consumption of such members. The activity of the assessee society cannot be considered as a consumer society since the members of the society did not consume the articles supplied by the society, but they used it for the manufacture of bricks and tiles. Explanation (i) to Rule 14 of the Co-operative Societies Rules defines " industrial society" to mean a society which has as its principal object the production of articles or finished goods through or with the help of its members or the provision of service facilities to its members who are artisans, technicians or small producers who are its members and includes any society which has as its principal object the provision of facilities for the operation of an industrial society. The Industrial society so defined has been classified under serial No.10, the categories of artisans, technicians, producers and industrial service society. The petitioner Society, in our view, would come within the second limb of explanation (i) to Rule 14.

20. As stated already, the claim has been made on the ground that the assessee is a consumer co-operative society. Hence, as per the provisions of the Act, the deduction granted in a sum of Rs.20,000/- is very much in accordance with law. Hence, the second question of law referred to in T.C.No.413 of 1999 is answered in affirmative in favour of the revenue and against the assessee.

21. In the result, the questions of law referred to us are answered as under:-

I Question (common):- Answered in the negative, in favour of the assessee and against the Revenue.

II Question:- Answered in the affirmative, in favour of the Revenue and against the assessee.

In the circumstances there will be no order as to costs.

Index: Yes
Website: Yes (N.V.B.,J.)(K.R.P.,J.)
USK/na

To:
1.The Assistant Registrar
Income-tax Appellate Tribunal
Rajaji Bhavan, Besant Nagar
Chennai-600 090

2.The Secretary
Central Board of Direct Taxes
New Delhi
3.The Commissioner of Income-tax
Tamil Nadu III

Madras

4.The Commissioner of Income-tax
(Appeals - iii),
Madras-34,
5.The Deputy Commissioner of
Income-tax, Special Range III
Madras.